MINUTES
of the
FOURTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

September 9, 2013
Room 322, State Capitol
Santa Fe

The fourth meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2013 interim was called to order by Representative Jim R. Trujillo, chair, on Monday, September 9, 2013, at 9:15 a.m. in Room 322 of the State Capitol in Santa Fe.

Present
Rep. Jim R. Trujillo, Chair
Sen. George K. Munoz, Vice Chair
Sen. Jacob. R. Candelaria
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Rep. William "Bill" R. Rehm
Rep. Luciano "Lucky" Varela

Absent
Sen. Sue Wilson Beffort
Rep. Larry A. Larrañaga
Rep. Henry Kiki Saavedra
Sen. William P. Soules

Advisory Members
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Rep. Sheryl Williams Stapleton

Rep. Donald E. Bratton
Rep. William "Bill" J. Gray
Sen. Stuart Ingle
Rep. Emily Kane
Sen. Timothy M. Keller
Rep. Tim D. Lewis
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. William H. Payne
Sen. John C. Ryan
Sen. Michael S. Sanchez

Guest Legislator
Rep. Alonzo Baldonado

Staff
Claudia Armijo, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Ric Gaudet, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

<u>Monday, September 9</u>

Education Trust Board (ETB); New Mexico College Savings Plans Overview

Dr. José Z. Garcia, secretary of higher education and chair, ETB; Jeremy Thiessen, investment consultant, Pension Consulting Alliance (PCA); Joseph Goldberg, attorney, Friedman Boyd Hollander Goldberg Urias & Ward; and Kevin Deiters, executive director, ETB, gave an overview of the ETB's programs and an update on the performance of the state's college savings plan funds. The ETB is the governing body for New Mexico's "529" college savings plans. It is entirely funded from fees and dividend revenues from the funds it administers. The ETB has two 529 plans it offers for sale: the Education Plan (EP), directly sold by the ETB, and the Scholar's Edge (SE), sold by the investment firm Oppenheimer Funds. The SE has more than 140,000 accounts in the state totaling $1.7 billion, while the EP has 21,000 accounts valued at $400 million. Both plans offer age-based and static portfolio investment strategies, and the SE allows investors to custom design their own investment strategies.

The ETB took several steps during the previous fiscal year to improve investment performance, including adopting a revised investment policy and monitoring guidelines, performing a comprehensive review of its portfolios, making changes to its investments to reduce the risk of lower yields due to higher interest rates and reducing fund manager risks. The ETB provides $500,000 per year in scholarships for first-time freshmen students who have graduated from a New Mexico high school with a minimum 3.25 grade point average and who demonstrate financial need.

Mr. Thiessen described the services provided to the ETB by PCA since 2011. PCA monitors and reports to the ETB on performance of both 529 plans and provides monthly and quarterly recommendations. The reports include ranked performance against other states' plans for multiple age groups. In the past year, New Mexico's portfolios have performed better than most other states, and the EP has performed slightly better than the SE plan. PCA has worked closely with the ETB and Oppenheimer Funds to monitor additional risks to the portfolios, including the very high risk of increased U.S. Treasury bond rates, which will have a negative impact on the fixed-income portfolio.

Committee members discussed with the panel many issues, including the following.

• What are the strategies that PCA and the ETB are pursuing to offset treasury bond rate increases? PCA recommends investing more in international bond funds, which will yield better than domestic bonds if interest rates rise in the U.S. When a student is in the last few years before entering college, most of that student's 529 plan is shifted to fixed-income investments to reduce risk of capital losses. However, at current interest rates, any increase in those treasury bond rates could mean capital losses for those plans.

• The ETB should consider investing the Lottery Tuition Fund in students' 529 plans three to five years before they enter college and require investment in a 529 plan in order to receive a lottery tuition scholarship.

• The ETB needs to recruit more people to invest in 529 plans. Mr. Deiters agreed but said that one reason people do not invest is that they believe the lottery tuition scholarships will pay for all college expenses. In fact, students in New Mexico borrowed $6.20 for every dollar they received in lottery tuition scholarships. The Lottery Tuition Fund is expected to incur a shortfall in a few years, which will require reduced scholarship amounts for all students.

• There is much confusion among the general public about New Mexico's college savings plans. Many residents believe that they will be forced to send their children to a New Mexico college if they invest in a New Mexico college savings plan.

• ETB staff was asked to provide disclosure information about the state's 529 plans to the committee.

Minutes

The minutes from the August 9, 2013 meeting of the IPOC were approved without changes.

Volunteer Firefighters' Retirement Plan: Eligibility, Plan Funding Sources and Solvency

Vernon Muller, deputy state fire marshal, and Wayne Propst, executive director, Public Employees Retirement Association (PERA), gave an update to the committee on recent changes to, and the current status of, the volunteer firefighters' retirement plan. The volunteer firefighters' retirement plan is in good shape with a funded ratio of 167%. There are slightly more than 5,000 active members and 633 retirees receiving a modest pension. The pension plan is funded by an annual distribution of $750,000 from the Fire Protection Fund. Active volunteer firefighters are eligible for a $125 or $250 monthly pension after serving 10 or 25 years and upon reaching age 55.

In 2009, the legislature made changes to service credit and reporting requirements to enhance the plan as a recruitment tool for potential volunteer firefighters. A volunteer firefighter's attendance requirements at department activities was reduced from 75% to 50%. In addition, years of service credit earned but not reported were allowed to be reported after the fact, and the documentation required to verify service credit was simplified. Since that legislation was enacted, many eligible firefighters have been given proper service credit, and ineligible firefighters were dropped from the potential pool of retirees. This has allowed for a better actuarial valuation of the fund. New legislation to limit the time frame to report previous service credit might be introduced in the coming legislative session to get a final understanding of who is eligible for a pension.

Committee members discussed with the panel some issues, including the following.

• Volunteer firefighters who subsequently become paid firefighters are unable to transfer any service credit toward their new plan.

• Fire departments are created by local governments, and the majority of them are staffed with volunteers. Some departments also have a few paid staff.

• Some regions with many calls per month make it difficult for volunteers to meet the 50% threshold to receive service credit. Mr. Muller said that fire chiefs are allowed to use some discretion in certifying eligibility for service credit.

• Fire departments need to do a better job of recruiting women to serve as firefighters.

Panel Discussion on New Governmental Accounting Standards Board (GASB) Rules Regarding the Reporting of Unfunded Public Pension Liabilities and New Auditing Requirements

State Treasurer James B. Lewis; Jeff Bridgens, CPA, Moss-Adams LLP; David Buchholz, bond disclosure counsel, State Board of Finance; and John Garrett, actuary, PERA, gave presentations on the new GASB Statement No. 68, "Accounting and Financial Reporting for Pensions", which is scheduled to take effect for fiscal years beginning after June 15, 2014. The panel discussion was moderated by State Treasurer Lewis and began with a detailed explanation by Mr. Bridgens of the new rule. Fundamentally, the new accounting standard requires governmental employers to report full pension liabilities as part of their financial statements, rather than just reporting those liabilities as informational items. This rule change has the possibility of significantly affecting the bottom lines of some governmental entities. The rule also changes the method of accounting for those pension plans, which might have the effect of increasing the calculated liability of some pension plans. However, the rule is not intended to be used for funding purposes, but only to better report long-term liabilities from an accounting point of view.

Pension liability is to be determined by calculating the net pension liability (NPL) of a plan, which consists of the total pension liability (TPL), less the plan's fiduciary net position. A plan's TPL is defined as the actuarial present value of projected benefit payments attributed to past periods. The biggest change to the methods of calculating TPL is the requirement to use a "blended" discount rate, consisting of the standard long-term expected rate of return for the fund and a top-rated municipal bond rate. This blended discount rate could have the effect of lowering the discount rate used to calculate TPL, which would mean that a pension plan's funded ratio would decrease.

Mr. Buchholz explained that the new rule has the possibility of affecting the rate received by the State Board of Finance when selling general obligation bonds or severance tax bonds (STBs) because bond disclosure statements include calculated pension liabilities. Increased pension liabilities could mean that the state must pay a higher interest rate when it sells bonds, even though those bond sales have very little to do with the state's pension liabilities.

Mr. Garrett summarized some of the impacts the new rule will have on governments, including the separation of accounting and funding of pension plans; moving NPL to the balance sheet of governmental employers; and the reporting of annual pension expense or even the absurdity of pension income with no direct relationship to the actuarially determined contributions made. He said that the GASB rule is intended solely for the purpose of financial reporting; ratings agencies measurements are solely for the purpose of assessing credit ratings; and neither of those measurements should be confused with the actual actuarial condition of a pension.

Committee members discussed with the panel many issues, including the following.

• How do ratings agencies interact with the new GASB rule? Mr. Buchholz said that ratings agencies assess the likelihood of repayment of bonds. In theory, STBs should only be rated on their repayment source: severance taxes. In reality, agencies look at the general credit of the state, including its budget process, reserves, expenditures for the future and pension liabilities. The most important thing for the state to do is to ensure the actual solvency of its pension funds and then worry about how to report its financial statements.

• The Department of Finance and Administration is unable to keep track of how much cash flow it has at any given time. The only reliable source of information is coming from the Office of the State Treasurer.

• Every county, municipality and local government will need to comply with the new GASB rule. The PERA and Educational Retirement Board will need to provide much information to local governments to ensure that they can comply with the reporting requirements. Mr. Propst said that the PERA will do as much as possible to provide information needed by governmental entities to comply with the reporting requirements.

• The Moody's rating agency recently downgraded the City of Santa Fe's bond rating based on faulty and incomplete information. In addition, Moody's discount rate measurement of five percent is absurd, according to a national bond association.

There being no further business, the committee adjourned at 3:40 p.m.